

PART V

POST-RETIREMENT ANNUITY INCREASES AND TAXES

A. INTRODUCTION

Chart 5, on pages 30 and 31, shows the provisions of each plan for increasing retirement annuities after an employee has retired. Chart 5 also shows how annuity payments from each plan are treated under that state's income tax laws. In addition, benefit adjustments in the Social Security program over the last 10 years and income taxation of Social Security benefits are also discussed in this part.

B. SOCIAL SECURITY

Pension designers are concerned with the adequacy of benefits at the time of retirement and also with the continuing purchasing power of those benefits during retirement as affected by inflation. Since 1975, Social Security benefits have been automatically adjusted each year by the percentage increase in the consumer price index (CPI). The increases in Social Security benefits for each of the last 10 years is shown below:

<u>CPI Year</u>	<u>Date on Which First Payable</u>	<u>Percentage Increase</u>
1996	1/1/1997	2.9%
1997	1/1/1998	2.1%
1998	1/1/1999	1.3%
1999	1/1/2000	2.4%
2000	1/1/2001	3.5%
2001	1/1/2002	2.6%
2002	1/1/2003	1.4%
2003	1/1/2004	2.1%
2004	1/1/2005	2.7%
2005	1/1/2006	4.1%

For those employees in the 68 of the 85 plans in this report (80%) that are also covered by the Social Security program, at least that portion of their total retirement income that is received from Social Security automatically keeps pace with inflation.

Under federal law, up to 50% of Social Security benefits are subject to income taxation if the taxpayer's adjusted income is between \$25,000 and \$34,000 for single taxpayers or between \$32,000 and \$44,000 for married taxpayers filing a joint income tax return. If a taxpayer's income exceeds these levels, then 85% of his or her Social Security benefits are subject to federal income taxation.

State income taxation of Social Security benefits varies. 26 states completely exempt Social Security benefits from income taxation. 15 states impose income taxes on all or a portion of

Social Security benefits and 9 states have no personal income tax or a very limited personal income tax that does not affect Social Security payments.

C. POST-RETIREMENT ANNUITY COST-OF-LIVING ADJUSTMENTS

Most of the plans in this report have provisions for post-retirement annuity adjustments to protect the purchasing power of annuities against inflation. These provisions of each of the plans are described in the fourth column of Chart 5. The following table summarizes and compares the post-retirement annuity adjustment provisions found in the 2002 Report against those found in the 2004 Report:

	<u>2002</u>	<u>2004</u>
Adjustments indexed to CPI	39 plans	38 plans
Automatic percentage increase	22 plans	23 plans
Investment surplus	3 plans	4 plans
Ad hoc (any increase must be authorized by Legislature or a decision-making board) or money purchase	21 plans	20 plans
TOTAL	85 plans	85 plans

Note that, as shown in Chart 5, many of the plans in which post-retirement annuity increases are indexed to the CPI also include a cap on the total percentage adjustment that may be made within any given year. Also, many of the plans in which post-retirement annuity increases are indexed to the CPI or are automatic also include provisions for additional annuity adjustments if there are investment surpluses in the retirement fund. 20 of the 85 plans are either money purchase plans or provide post-retirement annuity increases only on an "ad hoc" basis, where either the Legislature or a decision-making board determines whether, and when, a post-retirement annuity increase is granted.

D. STATE INCOME TAXATION OF ANNUITIES

The last column of Chart 5 shows the treatment of pension benefits under each of the plans by the state income tax laws in effect in that state. In 24 of the 85 plans, pension benefits are subject to state income taxation. In 21 of the 85 plans, pension benefits are totally exempt from state income taxation.

Caution must be used in interpreting the information in the last column of Chart 5. In many of the states in which pension income is fully taxable, other provisions of state income tax laws may ameliorate or completely eliminate the effect of the state income tax laws on retirees. For example, some state income tax laws have a level of exemptions, deductions, or tax credits that substantially reduce or eliminate state income taxation for persons at certain income levels. In addition, some of these exemptions, deductions, or tax credits may be increased for taxpayers who have reached a certain age. In these states, the level of income taxation on retirees may be equal to or less than that in states where public employee pension income is exempt from state income taxation.

E. TRENDS

Most of the plans in this report have adopted provisions in which retirement annuities are annually increased, either by a set percentage or in response to changes in the CPI. These provisions were mostly adopted in the 1970s and 1980s, in response to the high inflation that occurred in those years.

F. THE WRS

Retirees in the WRS whose annuities are paid from the "fixed" fund receive annual annuity adjustments tied to whether reserve surpluses in the fund, as adjusted by a formula, are sufficient to generate an increase. In addition, the annual adjustment may result in a reduction of annuities if investment losses are severe, particularly if investment losses occur over a number of consecutive years. However, annuities paid from the "fixed" fund may not be reduced below the level initially paid to a retiree. For annuities paid in 2004, the annuity adjustment in the fixed fund was 1.4%.

WRS retirement benefits are subject to state income taxation except for certain payments made with respect to persons who were employees prior to 1964 or who had retired prior to 1964. Beginning in 2008, income from Social Security will be completely exempt from Wisconsin income taxes.

CHART V
POST-RETIREMENT INCREASES AND STATE TAX PROVISIONS

<u>State</u>	<u>Fund Name</u>	<u>Social Security</u>	<u>Annual Post-Retirement Increases</u>	<u>State Taxation of PERS Benefits</u>
1 Alabama	ERS	Yes	Ad hoc only	Benefits exempt
2 Alabama	TRS	Yes	Ad hoc only	Benefits exempt
3 Alaska	PERS	No	75% of CPI if 65, 9% cap; 50% of CPI if 60 or retired 5 yrs. - 6% cap	No income tax law
4 Alaska	TRS	No	75% of CPI if age 65, 9% cap; 50% of CPI if 60 or retired 8 yrs.	No income tax law
5 Arizona	SRS	Yes	Excess earnings - 4% cap or CPI cap, whichever is less	Exempt to \$2,500
6 Arkansas	PERS	Yes	3%	Exempt to \$6,000
7 Arkansas	TRS	Yes	3%	Exempt to \$6,000
8 California	PERS	Yes	2%	Benefits taxable
9 California	TRS	No	2%	Benefits taxable
10 Colorado	PERA	No	3.5%	Exempt to \$20,000/\$24,000
11 Connecticut	SERS	Yes	60% of CPI up to 6%, 75% of CPI over 6%	Benefits taxable
12 Connecticut	TRS	No	Excess earnings: 1.5% or 6% cap	Benefits taxable
13 Delaware	SEPP	Yes	Ad hoc only	Exempt to \$12,500
14 Florida	FRS	Yes	3%	No income tax law
15 Georgia	ERS	Yes	CPI - 1.5% semi-annual cap	Exempt to \$15,000
16 Georgia	TRS	Yes	CPI - 1.5% semi-annual cap	Exempt to \$15,000
17 Hawaii	ERS	Yes	2.5%	Benefits exempt
18 Idaho	PERS	Yes	CPI - 1% minimum to 6% max. (conditional)	Benefits taxable
19 Illinois	SERS	Yes	3%	Benefits exempt
20 Illinois	TRS	No	3%	Benefits exempt
21 Illinois	MRF	Yes	3%	Benefits exempt
22 Indiana	PERF	Yes	Ad hoc only	Benefits taxable
23 Indiana	TRF	Yes	Ad hoc only	Benefits taxable
24 Iowa	PERS	Yes	Excess earnings - 3% cap	Exempt to \$6,000, \$12,000 married
25 Kansas	PERS	Yes	Ad hoc only	Benefits exempt
26 Kentucky	ERS	Yes	CPI - 5% cap	Prorated exemption
27 Kentucky	TRS	No	1.5% + 1.4% ad hoc for 2002	Prorated exemption
28 Louisiana	SERS	No	Ad hoc only	Benefits exempt
29 Louisiana	TRSL	No	CPI - 3% cap	Benefits exempt
30 Maine	SRS	No	CPI - 4% cap	Exempt to \$6,000
31 Maryland	SRS	Yes	CPI - 3% cap	Benefits taxable
32 Massachusetts	SERS	No	CPI - on 1st \$12,000-conditional, 3% cap	Benefits exempt
33 Massachusetts	TRS	No	CPI - on 1st \$12,000-conditional, 3% cap	Benefits exempt
34 Michigan	SERS	Yes	3% (\$300 annual cap)	Benefits exempt
35 Michigan	MERS	Yes	3 plans - depending on employer agreement	Benefits exempt
36 Michigan	PSERS	Yes	3%	Benefits exempt
37 Minnesota	MSRS	Yes	CPI - 2.5% cap plus investment surplus	Exempt to \$14,500/18,000
38 Minnesota	PERA	Yes	CPI - 2.5% cap plus investment surplus	Exempt to \$14,500/18,000
39 Minnesota	TRA	Yes	CPI - 2.5% cap plus investment surplus	Exempt to \$14,500/18,000
40 Mississippi	PERS	Yes	3%	Benefits exempt

41	Missouri	SERS	Yes	80% CPI: 5% cap	Benefits taxable
42	Missouri	LAGERS	Yes	CPI - 4% cap	Exempt to \$6,000/12,000
43	Missouri	PSRS	N	CPI - 80% of original benefits lifetime cap	Exempt to \$6,000/12,000
44	Montana	PERS	Yes	3%	Benefits taxable
45	Montana	TRS	Yes	1.5%	Exempt to \$3,600
46	Nebraska	SERS	Yes	Money purchase	Benefits taxable
47	Nebraska	SPP	Yes	CPI - 2.5% cap	Benefits taxable
48	Nevada	PERS	No	2% to 5% (varies) with number of years retired	No income tax law
49	New Hampshire	NHRS	Yes	Ad hoc	Benefits exempt
50	New Jersey	PERS	Yes	60% of CPI	Exempt to \$15,000/20,000
51	New Jersey	TPAF	Yes	60% of CPI	Exempt to \$15,000/20,000
52	New Mexico	PERA	Yes	3%	Exempt to \$8,000/16,000
53	New Mexico	ERA	Yes	50% of CPI - 4% cap	Exempt to \$8,000/16,000
54	New York	ERS	Yes	50% of CPI on up to \$18,000 of annuity	Benefits exempt
55	New York	TRS	Yes	If age 62 + retired 5 yrs.: 50% of CPI, max. 3% on 1st \$18,000	Benefits exempt
56	North Carolina	TSERS	Yes	Ad hoc	Exempt to \$4,000/8,000
57	North Carolina	LGERS	Yes	Ad hoc	Exempt to \$4,000/8,000
58	North Dakota	PERS	Yes	Ad hoc	Benefits taxable
59	North Dakota	TRF	Yes	Ad hoc	Benefits taxable
60	Ohio	PERS	No	CPI - 3% cap	Benefits taxable
61	Ohio	STRS	No	CPI - 3% cap	Benefits taxable
62	Oklahoma	PERS	Yes	2.5% to 4.5% depending on service and salary level	Exempt to \$7,500
63	Oklahoma	TRS	Yes	Ad hoc	Exempt to \$7,500
64	Oregon	PERS	Yes	CPI - 2% cap	Benefits taxable
65	Pennsylvania	SERS	Yes	Ad hoc	Benefits exempt
66	Pennsylvania	PSERS	Yes	Ad hoc	Benefits exempt
67	Rhode Island	ERS	Yes	3%	Benefits taxable
68	South Carolina	SCRS	Yes	CPI - 4% cap	Exempt to \$10,000
69	South Dakota	SRS	Yes	3.1%	No income tax law
70	Tennessee	CRS	Yes	CPI - 3% cap	Benefits exempt
71	Texas	ERS	Yes	Ad hoc	No income tax law
72	Texas	TRS	No	Ad hoc	No income tax law
73	Texas	MRS	Yes	Up to 70% of CPI (employer option)	No income tax law
74	Utah	SRS	Yes	CPI - 4% cap	Exempt to \$7,500/15,000
75	Vermont	SRS	Yes	50% of CPI - 5% cap	Benefits taxable
76	Vermont	TRS	Yes	50% of CPI - 5% cap	Benefits taxable
77	Virginia	SRS	Yes	CPI - 5% cap	Exempt to \$12,000
78	Washington	PERS	Yes	CPI - 3% cap	No income tax law
79	Washington	TRS	Yes	CPI - 3% cap	No income tax law
80	West Virginia	PERS	Yes	Ad hoc	Exempt to \$2,000
81	West Virginia	TRS	Yes	Ad hoc	Exempt to \$2,000
82	Wyoming	WRS	Yes	CPI - 3% cap	No income tax law
83	Milwaukee	City	Yes	2% after 5 yrs. retired	Exempt for some
84	Milwaukee	County	Yes	2%	Exempt for some
85	Wisconsin	WRS	Yes	Investment earnings; reductions possible	Exempt for some

PART VI

ACTUARIAL AND ACCOUNTING INFORMATION

A. INTRODUCTION

Chart 6, on pages 36 and 37, provides selected actuarial and accounting information about each of the plans in the report. This part of the report discusses the actuarial method used by each of the plans, provides the interest assumption, wage inflation assumption, and economic spread for each of the plans and provides the Governmental Accounting Standards Board (GASB) 25 funding ratio for each of the plans in 2002.

B. ACTUARIAL METHODS

The third column in Chart 6 lists the actuarial methods used by each of the 85 plans. An actuarial method is a procedure for determining the present value of pension benefits that will be paid in the future, and allocating that value and the cost of the benefits to specific time periods. There are a number of accepted actuarial methods that presumably will reach the goal of fully funding all pension obligations as they become due, but they allocate costs in different ways during the period of employment of participants in the plan.

66, or 78%, of the 85 plans use the entry age actuarial method; 13, or 15%, of the 85 plans use the unit credit method; 6 of the 85 plans use the aggregate cost method or other methods.

C. INTEREST ASSUMPTION

The interest assumption, which is also sometimes referred to as the "earnings assumption," is one of the key economic assumptions in determining the level of contribution rates. The fourth column in Chart 6 provides the interest assumption for each of the 85 plans in the report. This information is compared with previous reports on the following table:

<u>Interest Assumption</u>	<u>2000</u>	<u>2002</u>	<u>2004</u>
From 5% to 7%	1 plan	1 plan	1 plan
Over 7% to 8%	56 plans	56 plans	59 plans
Over 8%	27 plans	27 plans	24 plans
Not determined	1 plan	1 plan	1 plan
TOTAL	85 plans	85 plans	85 plans

D. ECONOMIC SPREAD

Another key economic assumption in pension planning is the assumption of the wage inflation rate, or general salary increases in excess of those provided for merit or seniority. The difference between the wage inflation assumption and the interest assumption is often referred to as the "economic spread," which is the assumed real rate of return on invested assets above the wage inflation rate. The fifth and sixth columns of Chart 6 show the wage inflation assumptions and the resultant economic spread for each of the plans in the report.

E. FUNDING RATIO

Until 1995, the GASB required public pension plans to disclose the "pension benefit obligation," which is a measure of the present value of pension benefits, adjusted for the effects of projected salary increases. The pension benefits were estimated only on service earned by employees up to the date of the estimate.

GASB statement #25, issued in November 1994, requires that, for funding disclosures beginning with periods after June 15, 1996, the funding disclosures be based upon regular actuarial valuations. Included in the requirements under GASB 25 is a "schedule funding progress that reports the actuarial value of assets, the actuarial accrued liability and the relationship between the two over time...."

The following table summarizes the funding ratios for each of the plans in the 2004 Report, and compares them with the 2002 and 2000 Reports.

<u>Funding Ratio</u>	<u>2000</u>	<u>2002</u>	<u>2004</u>
More than 100%	33 plans	28 plans	9 plans
90% to 100%	22 plans	21 plans	28 plans
80%, but less than 90%	14 plans	15 plans	19 plans
70%, but less than 80%	5 plans	7 plans	15 plans
60%, but less than 70%	1 plan	3 plans	7 plans
50%, but less than 60%	1 plan	4 plans	3 plans
Less than 50%	3 plans	1 plan	2 plans
Not determined	6 plans	6 plans	2 plans
TOTAL	85 plans	85 plans	85 plans

F. TRENDS

Funding ratios of more than 100% have decreased substantially since the 2000 Report, reflecting the general decline in earnings that occurred during the period. 33 plans had funding ratios in excess of 100% in 2000, but only 9 plans had funding ratios in excess of 100% in 2004. However, 45% of the plans studied had funding ratios in excess of 90% in 2004. The average funding ratio in 2004 was 84.8%.

Since the 2002 Report, no changes were made in the actuarial methods used by the 85 plans. The entry age method is the predominant method used by the plans studied.

G. THE WRS

The actuarial method used by the WRS is entry age, which is the most prevalent method used by the 85 plans in the report. The interest assumption for 2004 is 7.8%, which is slightly less than the average interest assumption of 8.01%. The "economic spread" used by the WRS is 3.7% which is less than the average economic spread of 3.93%.

For 2004, the funding ratio for the WRS was 99.4%, which was greater than the average funding ratio of 84.8% for the plans studied.

CHART VI
ACTUARIAL AND ACCOUNTING PROVISIONS

	<u>State</u>	<u>Fund Name</u>	<u>Actuarial Method</u>	<u>Interest Assumption</u>	<u>Wage Inflation</u>	<u>Economic Spread</u>	<u>Funding Ratio</u>
1	Alabama	ERS	Entry age	8%	4.5%	3.5%	91.1%
2	Alabama	TRS	Entry age	8%	4.5%	3.5%	97.4%
3	Alaska	PERS	Unit credit	8.25%	3.5%	4.75%	70.2%
4	Alaska	TRS	Unit credit	8.25%	3.5%	4.75%	62.8%
5	Arizona	SRS	Unit credit	8%	4.2%	3.8%	96.8%
6	Arkansas	PERS	Entry age	8%	4%	4%	89%
7	Arkansas	TRS	Entry age	8%	4%	4%	86%
8	California	PERS	Entry age	7.75%	3%	4.75%	87.7%
9	California	TRS	Entry age	8%	4.25%	3.75%	82%
10	Colorado	PERA	Entry age	8.5%	3.75%	4.75%	70.1%
11	Connecticut	SERS	Unit credit	8.5%	N.D.	N.D.	57%
12	Connecticut	TRS	Entry age	8.5%	4%	4.5%	68.4%
13	Delaware	SEPP	Entry age	8%	3.75%	4.25%	103%
14	Florida	FRS	Entry age	7.75%	3%	4.75%	112.1%
15	Georgia	ERS	Entry age	7.25%	3.5%	3.75%	100.5%
16	Georgia	TRS	Entry age	7.25%	3.75%	3.5%	101.1%
17	Hawaii	ERS	Entry age	8%	4%	4%	71.7%
18	Idaho	PERS	Entry age	7.75%	4.5%	3.25%	91.7%
19	Illinois	SERS	Unit credit	8.5%	3%	5.5%	54.2%
20	Illinois	TRS	Unit credit	8.5%	3.5%	5%	61.9%
21	Illinois	MRF	Entry age	7.5%	4%	3.5%	94.2%
22	Indiana	PERF	Entry age	7.25%	N.D.	N.D.	102.9%
23	Indiana	TRF	Entry age	7.5%	4.5%	3%	63%
24	Iowa	PERS	Entry age	7.5%	4%	3.5%	88.6%
25	Kansas	PERS	Entry age	8%	3.5%	4.5%	75%
26	Kentucky	ERS	Entry age	8.25%	3.5%	4.75%	85.8%
27	Kentucky	TRS	Unit credit	7.5%	4%	3.5%	81%
28	Louisiana	SERS	Unit credit	8.25%	N.D.	N.D.	59.3%
29	Louisiana	TRSL	Unit credit	8.25%	3.2%	5.05%	63.1%
30	Maine	SRS	Entry age	8%	5.5%	2.5%	74.7%
31	Maryland	SRS	Entry age	7.75%	4%	3.75%	92.2%
32	Massachusetts	SERS	Entry age	8.25%	N.D.	N.D.	83.9%
33	Massachusetts	TRS	Entry age	8.25%	N.D.	N.D.	69.6%
34	Michigan	SERS	Entry age	8%	4%	4%	88.8%
35	Michigan	MERS	Entry age	8%	4.5%	3.5%	78.7%
36	Michigan	PSERS	Entry age	8%	4%	4%	86.5%
37	Minnesota	MSRS	Entry age	8.5%	N.D.	N.D.	100.1%
38	Minnesota	PERA	Entry age	8.5%	N.D.	N.D.	76.7%
39	Minnesota	TRA	Entry age	8.5%	N.D.	N.D.	100%
40	Mississippi	PERS	Entry age	8%	4%	4%	74.9%

41	Missouri	SERS	Entry age	8.5%	4%	4.5%	84.6%
42	Missouri	LAGERS	Entry age	7.5%	4%	3.5%	95.9%
43	Missouri	PSRS	Entry age	8%	N.D.		82%
44	Montana	PERS	Entry age	8%	4.25%	3.75%	87%
45	Montana	TRS	Entry age	7.75%	4.5%	3.25%	74%
46	Nebraska	SERS		N.D.	N.D.	N.D.	N.D.
47	Nebraska	SPP	Entry age-FIL	8%	N.D.	N.D.	103.2%
48	Nevada	PERS	Entry age	8%	3.5%	4.5%	78.7%
49	New Hampshire	NHRS	Aggregate	9%	3.5%	5.5%	72.1%
50	New Jersey	PERS	Unit credit	8.75%	5.95%	2.8%	90.7%
51	New Jersey	TPAF	Unit credit	8.75%	5.95%	2.8%	92.7%
52	New Mexico	PERA	Entry age	8%	4.5%	3.5%	93%
53	New Mexico	ERB	Entry age	8%	3.5%	4.5%	75.4%
54	New York	ERS	Aggregate	8%	3%	5%	N.D.
55	New York	TRS	Aggregate	8%	3%	5%	99.4%
56	North Carolina	TSERS	Entry age	7.25%	N.D.	N.D.	108%
57	North Carolina	LGERS	Entry age	7.25%	N.D.	N.D.	99%
58	North Dakota	PERS	Entry age	8%	4.5%	3.5%	94%
59	North Dakota	TRF	Entry age	8%	3%	5%	80.3%
60	Ohio	PERS	Entry age	8%	4%	4%	85%
61	Ohio	STRS	Entry age	8%	3.5%	4.5%	74.8%
62	Oklahoma	PERS	Entry age	7.5%	3%	4.5%	76.1%
63	Oklahoma	TRS	Entry age	8%	3.5%	4.5%	47.3%
64	Oregon	PERS	Entry age	8%	4.25%	3.75%	90%
65	Pennsylvania	SERS	Entry age	8.5%	3%	5.5%	96.1%
66	Pennsylvania	PSERS	Entry age	8.5%	3.5%	5%	97.2%
67	Rhode Island	ERS	Entry age	8.25%	3%	5.25%	65.5%
68	South Carolina	SCRS	Entry age	7.25%	3%	4.25%	82.8%
69	South Dakota	SRS	Entry age	8%	N.D.	N.D.	97.7%
70	Tennessee	CRS	Entry age-FIL	7.5%	N.D.	N.D.	99.8%
71	Texas	ERS	Entry age	8%	4%	4%	97.3%
72	Texas	TRS	Entry age	8%	3%	5%	91.8%
73	Texas	MRS	Unit credit	7%	N.D.	N.D.	80.2%
74	Utah	SRS	Entry age	8%	4.75%	3.25%	93%
75	Vermont	SRS	Entry age-FIL	8%	N.D.	N.D.	97.6%
76	Vermont	TRS	Entry age-FIL	8%	N.D.	N.D.	90.2%
77	Virginia	SRS	Entry age	8%	3%	5%	96.4%
78	Washington	PERS	Aggregate	8%	4.5%	3.5%	93%
79	Washington	TRS	Aggregate	8%	4.5%	3.5%	93%
80	West Virginia	PERS	Entry age	7.5%	3.5%	4%	80%
81	West Virginia	TRS	Entry age	8%	3.5%	4.5%	22.2%
82	Wyoming	WRS	Entry age	8%	5%	3%	85%
83	Milwaukee	City	Unit credit	8.5%	3%	5.5%	116%
84	Milwaukee	County	Entry age	8.5%	5.5%	3%	79.9%
85	Wisconsin	WRS	Entry age-FIL	7.8%	4.1%	3.7%	99.4%

*N.D. = Not determined.